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Message Text

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17
ACTION OPIC-06

INFO OCT-01 EA-07 ISO-00 EB-07 COME-00 L-03 TRSE-00 /024 W
---------- 083798
R 130611Z SEP 76
FM AMEMBASSY SEOUL
TO SECSTATE WASHDC 9386

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PASS: OPIC

EO 11652: N/A
TAGS: EFIN EINV KS
SUBJ: PUBLIC COPORATION LAW AND U.S. INVESTORS

REF: SEOUL A-170 OF 4 SEPT 1975

SUMMARY: IN THE CONTEXT OF ITS STANDING POLICY OF ENCOURAGING LARGE, CLOSELY-HELD PRIVATE FIRMS TO GO PUBLIC (REFAIR), THE KOREAN MINISTRY OF FINANCE (MOF) THROUGH THE KOREAN INVESTMENT CORPORATION (KIC) HAS ADVISED A LARGE NUMBER OF FIRMS, INCLUDING FOUR JOINT VENTURE FIRMS WITH U.S. EQUITY INVESTMENT, THAT THEY HAVE BEEN DESIGNATED TO SELL PART OF THIER CAPITAL STOCK TO THE PUBLIC, FAILING WHICH THEY WILL BE SUBECT TO VARIOUS PENALTIES IN ACCORDANCE WITH EXISTING LAW. THE FOUR HAVE TOLD US THAT THEY WOULD PREFER NOT TO SELL ANY OF THEIR HOLDINGS. MOF HAS TOLD US THAT UNDER CERTAIN CIRCUMSTANCES IT WOULD INDEED REQUIRE A FOREIGN-INVESTED COMPANY TO SELL PART OF ITS EQUITY AND WOULD IMPOSE PENALTIES ON ANY THAT DO NOT COMPLY. EXCEPT FOR ONE, THE U.S. FIRMS HAVE OPIC EXPROPORATION INSURANCE. OPIC MAY WISH TO REVIEW WHETHER SUCH ROKG ACTION GIVES U.S. INVESTORS A SOUND BASIS FOR AN EXPORPORIATION CLAIM AGAINST OPIC, AS THE ROKG WOULD UNDOUBTEDLY WISH TO CONSIDER OPIC'S VIEWS. END SUMMARY.

1. AS NOTED IN THE REFERNCE AIRGRAM AND PREVIOUS
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MESSAGES, AS PART OF A SOCIOECONOMIC PROGRAM TO DIS-

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PERSE OWNERSHIP OF CORPORATIONS, IN 1972 KOREA ENACTED
A LAW BY WHICH THE ROKG WAS GIVEN AUTHORITY TO DESIGNATE
CORPORATIONS AND ISSUE ORDINANCES TO REQUIRE CORPORATIONS
TO GO PUBLIC. THE PROGRAMS'S AIMS, WHICH THE GOVERNMENT
HAS PURSUED THROUGH A SET OF INCENTIVES AND PENALTIES,
ARE TO INDUCE CLOSELY HELD COMPANIES TO GO PUBLIC SO
AS TO AVOID THE CREATION OF A PLUTOCRACY AND TO DISPERSE
THE ECONOMIC BENEFITS OF DEVELOPMENT AS WIDELY AS
POSSIBLE.

2. ON JULY 1 THE MINISTRY OF FINANCE (.MOF) ADVISED
101 KOREAN COMPANIES THAT THEY WOULD BE REQUIRED TO
SUBMIT FINANCIAL INFORMATION TO THE KOREA INVESTMENT
CORPORATION (KIC), A STATE-OWNED ENTITY, TO DETERMINE
WHEHTER THEY SHOULD BE REQUIRED TO SELL PART OF THEIR
CAPITAL STOCK TO THE PUBLIC UNDER THE PROVISIONS OF
THE PUBLIC CORPORATION INDUCEMENT LAW (PCIL). THE
FIRMS WERE GIVEN UNTIL JULY 24 TO COMPLY WITH THE RE-
QUEST FOR DETAILED INFORMATION ABOUT THEIR FINANCIAL
CONDITION. INCLUDED AMONG THE 101 COMPANIES WERE 16
WITH FOREIGN-OWNED EQUITY, OF WHICH FOUR HAVE DIRECT
U.S. PARTICIPATION. THE FOUR U.S. FIRMS AND THEIR
HOLDINGS ARE APPARENTLY SUBJECT TO THE PROVISIONS OF
THE PCIL. THEY ARE CALTEX (HONAM OIL REINERY CORPORATION,
50 PERCENT), PFIZER INC. (PFIZER KOREA LIMITED,
50 PERCENT), GENERAL FOODS CORPORATION (HONG SUH
FOOD INDUSTRIES CO. LTD., 33 1/3 PERCENT), AND
CONTINENTAL CARBON CORPORATION (KOREA CONTINENTAL
CARBON, 50 PERCENT). OF THESE, ALL BOUT GENERAL FOODS
HAVE OPIC EXPROPRIATION INSURANCE. ONE OTHER FIRM,
HONAM TANKER CORP., IS A WHOLLY-OWNED SUBSIDIARY OF
A U.S. - INVESTED JOINT VENTURE FIRM (HONAM OIL REFINERY
CORPORATION), BUT HONAM TANKER CORP. DOES NOT IN FACT
FALL UNDER THE PCIL BECAUSE ITS OUTSTANDING CAPITAL
DOES NOT MEET THE MIMIMUM REQUIREMENT. IN 1975 THE
MOF TOOK SIMILAR ACTION WITH RESPECT TO 105 FIRMS, BUT
NONE HAD U.S. OWNERSHIP.

3. ON AUGUST 27 KIC SENT FORM LETTERS TO ALL FIRMS ON
THE JULY 1 LIST TO ADVISE THEM OF ITS FINDINGS.
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EIGHTY-EIGHT FIRMS WERE ADVISED THAT THEY MUST GO PUBLIC;
THIRTEEN WERE TOLD THAT FURTHER ANALYSIS WOULD BE
NECESSARY. TWENTY-THREE WILL BE REQUIRED TO SELL
SHARES TO THE PUBLIC BY OCTOBER 31, TWENTY-THREE BY
DECEMBER 31, THRITY-THREE BEFORE APRIL 1, 1977, AND THE
REMAINING NINE BY JUNE 30, 1977. HONAM OIL (CALTEX)
WAS GIVEN UNTIL JUNE 30, 1977; THE OTHER THREE WITH
AMERICAN PARTICIPATION TO APRIL 30, 1977.

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4. WE HAVE SPOKEN WITH THE U.S. INVESTED COMPANIES,
AND ALL HAVE TOLD US THAT THE U.S. PARENTS DO NOT WISH
TO SELL ANY OF THEIR EQUITY. FURTHERMORE, ALL WOULD
PREFER THAT THE KOREAN EQUITY REMAIN UNDISTRUBED, BUT
THEY BELIEVE THAT THE LAW REQUIRES THEIR KOREAN PARTNERS
TO SELL PART OF THEIR EQUITY IF ORDERED TO DO SO. AS
FOR THEIR OPINION OF THE APPLICABILITY OF THE LAW TO
THE U.S.-OWNED EQUITY, THERE IS NO UNANIMITY. ONLY
PFIZER CONSULTED THEIR LOCAL ATTORNEY AND WERE TOLD
THAT KOREAN LAW CONTAINED NO PROVISIONS WHICH GUARANTEED
THAT PFIZER COULD MAINTAIN ITS SHARE OF THE COMPANY
INDEFINITELY. GENERAL FOODS AND CONTINENTAL CARBON
TOLD US THEY BELIEVE THAT THE FOREIGN CAPITAL INDUCE-
MENT LAW (FCIL) PROTECTS THEIR EQUITY. CALTEX
CONTENDS THAT THEIR JOINT VENTURE AGREEMENT, WHICH
PROVIDES FOR CALTEX TO HOLD 50 PERCENT OF THE
ENTERPRISE AND WHICH THE ROKG APPROVED, WOULD HAVE
TO BE HONORED.

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ACTION OPIC-06

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PASS: OPIC

5. THERE IS NO PROVISION OF THE FCIL WHICH SPECIFICALLY
EXEMPTS FOREIGN CAPITAL INVESTED THEREUNDER FROM DESIGNATION
UNDER THE PCIL. ARTICLE 23, PARA 2 OF THE FCIL WOULD SEEM,
BY INFERENCE, TO ACKNOWLEDGE THAT FCIL JOINT VENTURES DO FALL
WITHIN THE PURVIEW OF THE PCIL; IT PROVIDES THAT PRIOR
PERMISSION TO SELL CAPITAL STOCK IS NOT REQUIRED IF THE
ENTERPRISE HAS BEEN DESIGNATED FOR PUBLIC OFFERING UNDER
THE PROVISION OF ARTICLE 4 OF THE PCIL. ARTICLE 17 OF THE

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FCIL ACCORDS JOINT VENTURES NATIONAL TREATMENT. ARTICLE 4 OF THE PCIL PROVIDES FOR EXEMPTIONS FOR FCIL JOINT VENTURES. HOWEVER, THE EXEMPTIONS ARE VERY VAGUE, AND, ACCORDING TO MOF OFFICIALS, NO COMPANIES HAVE AS YET BEEN ACCEPTED AS QUALIFYING FOR THE EXEMPTIONS.

6. THE PCIL PROVIDES THAT A CORPORATION DESIGNATED BY THE ROKG TO GO PUBLIC WILL BE GIVEN A SPECIFIED TIME IN WHICH TO COMPLY. ARTICLES 16-18 OF THE PCIL PROVIDE PENALTIES FOR FIRMS WHICH DO NOT GO PUBLIC BEFORE THE DEADLINE SUCH AS INCREASED CORPORATE TAX, LIMITED DEDUCTIONS FOR BUSINESS ENTERTAINMENT, LOSS OF SPECIAL DEPRECIATION, INCREASED TAXES ON DIVIDENDS FROM THE CORPORATION AND POSSIBLE RESTRICTIONS ON CREDIT. (FIRMS WHICH DO COMPLY OR OTHERWISE QUALIFY AS PUBLIC CORPORATIONS UNDER THE CORPORATION TAX LAW ARE ELIGIBLE TO RECEIVE SUBSTANTIAL TAX BREAKS. SEE REFAIR.) IN THE CASE OF THE CORPORATION TAX, THE PENALTY RATE IS VERY HIGH COMPARED WITH THAT PAID BY A PUBLIC CORPORATION. INCLUDING DEFENSE TAX, A DELINQUENT LIMITED OFFICIAL USE

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CORPORATION WOULD PAY CORPORATE TAX OF 57.6 PERCENT COMPARED WITH 32.4 PERCENT FOR A PUBLIC CORPORATION. FOR A CLOSED, NON-DELINQUENT CORPORATION THE RATE IS 48 PERCENT. MOF OFFICIALS INCLUDING MINISTER KIM YONG-HWAN HAVE TOLD US THAT THEY WILL SEEK TO PRESERVE THE MANAGEMENT INTERESTS OF THE ORIGINAL INVESTOR. HOWEVER, THE ROKG STILL INTENDS TO REQUIRE THE PARTIAL DIVESTITURE OF CAPITAL STOCK BY DESIGNATED FOREIGN CORPORATIONS IN THOSE CASES WHERE IT WOULD NOT CONFLICT WITH THE FCIL. ONE SPECIFIC EXAMPLE CITED BY A MOF OFFICIAL AS BEING PROTECTED BY THE FCIL IS THE CASE OF CALTEX, WHERE THE JOINT VENTURE AGREEMENT CONTAINS PROVISIONS WHICH DELINEATE THE EXTENT OF FOREIGN PARTICIPATION. THERE, HOWEVER, THE ROKG WOULD EXPECT THE CORPORATION TO ESTABLISH A HOLDING COMPANY. UNDER THAT SETUP, THE ASSETS OF A HOLDING COMPANY WOULD INCLUDE AT LEAST 30 PER-CENT OF THE CAPITAL STOCK OF THE CORPORATION WITH EQUAL AMOUNTS COMING FROM EACH PARTNER. IN SUCH CASES AN EXCEPTION TO THE DEFINITION OF AN OPEN CORPORATION WOULD BE GRANTED.

7. ACCORDING TO PRESENT LAW AND REGULATIONS AN OPEN CORPORATION IS ONE IN WHICH 40 PERCENT OF THE OUTSTANDING SHARES ARE HELD BY MINORITY SHAREHOLDERS (THOSE OWNING ONE PERCENT OR LESS OR 50 MILLION WON PAR VALUE, WHICHEVER IS LESS) AND 30 PERCENT OF THE OUTSTANDING SHARES HAVE BEEN OFFERED TO THE PUBLIC. MOF HAS INDICATED THAT FOR FCIL ENTERPRISES, THE REQUIREMENT WOULD BE LOWERED TO 30 PERCENT MINORITY OWNERSHIP. IN CASES WHERE 50 PERCENT IS HELD BY EACH PARTNER, EACH WOULD BE REQUIRED TO SELL 15 PERCENT OF THE COMPANY STOCK. OTHER SPECIFIC CASES WHICH MOF OFFICIALS INDICATED WOULD REQUIRE EXCEPTIONAL TREATMENT ARE: 51-49 JOINT VENTURES (THE MAJORITY SHAREHOLDER'S CONTROL WOULD

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BE ELIMINATED IF FORCED TO DIVEST) AND A 66 2/3 - 33 1/3 PARTNER-
SHIP IN WHICH THE JOINT VENTURE AGREEMENT REQUIRES A GREATER
THAN 2/3'S MAJORITY ON IMPORTANT MATTERS. IN THE FORMER,
ACCORDING TO THE MOF, IT WOULD BE EXPECTED THAT PUBLIC
PARTICIPATION WOULD BE THROUGH A HOLDING COMPANY ARRANGEMENT;
IN THE LATTER CASE THE MAJORITY PARTNER WOULD BE REQUIRED TO
REDUCE HIS HOLDING TO 40 PERCENT WHILE THE MINORITY PARTNER
WOULD NOT BE REQUIRED TO SELL ANY HOLDINGS. IN ANY EVENT, ANY
EXCEPTIONS WOULD BE ON A CASE-TO-CASE BASIS AND BASED ON THE
PROVISIONS OF THE JOINT VENTURE AGREEMENT.

8. A PROBLEM COULD ARISE IF THE ROKG IMPOSED SANCTIONS ON A
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U.S. CORPORATION WHICH THEN FILED AN EXPROPRIATION CLAIM WITH
OPIC. THERE SEEMS TO BE NO QUESTION OF EXPROPRIATION WITHOUT
COMPENSATION, WHERE THE U.S. INVESTOR CHOOSES TO SELL HIS
SHARES, IN ALL LIKELIHOOD AT A PROFIT. THE FCIL PROVIDES FOR
THE REMITTANCE OF THE PROCEEDS OF THE SALE OF ALL OR PART OF A
FOREIGN INVESTOR'S SHARE. HOWEVER, TWO OTHER GROUNDS FOR CLAIMS
FOR COMPENSATION AGAINST OPIC MIGHT BE ARGUED: (A) LOST EARNINGS
ON THAT PORTION OF ITS INVESTMENT THE U.S. FIRM MAY BE REQUIRED
TO SELL AND (B) EARNINGS TAXED AWAY BY THE PENALTIES IMPOSED
IF THE COMPANY DOES NOT GO PUBLIC. WE BELIEVE, HOWEVER, THAT THE
ROKG WOULD TRY TO CONTEST THE CLAIM ON THE GROUNDS THAT THE
FOREIGN INVESTOR HAD BEEN OFFERED ADEQUATE COMPENSATION THROUGH
THE AVENUE OF SALE OF HIS SHARES AND HAD CHOSEN NOT TO TAKE
IT. THE THREE OPIC INSURED COMPANIES INVOLVED THIS YEAR HAVE
GIVEN NO INDICATION THEY WOULD PUT FORTH A CLAIM, BUT MAY HOPE
THAT THE ROKG WILL BACK OFF. THE ROKG RECOGNIZES THAT THE
PROBLEM IS A DELICATE ONE, WHICH COULD AFFECT THE BUSINESS
CLIMATE HERE.

9. ACTION SUGGESTED: OPIC MAY WISH TO REVIEW THE MATTER NOW TO
DETERMINE WHETHER GROUNDS EXIST FOR AN EXPROPRIATION CLAIM.
IF SO, PLEASE ADVISE US, AS WE BELIEVE THIS CONSIDERATION WOULD
BE GIVEN GREAT WEIGHT BY THE ROKG. WE ARE FORWARDING COPIES OF
THE PCIF, FCIL AND PRESIDENTIAL DECREES BY AIRGRAM.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: SALES, POLICIES, BUSINESS FIRMS, STOCKS (SECURITIES)
Control Number: n/a
Copy: SINGLE
Draft Date: 13 SEP 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: izenbei0
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976SEOUL07230
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D760344-0483
From: SEOUL
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760966/aaaacerh.tel
Line Count: 266
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION OPIC
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 76 SEOUL A-170
Review Action: RELEASED, APPROVED
Review Authority: izenbei0
Review Comment: n/a
Review Content Flags:
Review Date: 28 MAY 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <28 MAY 2004 by ShawDG>; APPROVED <27 SEP 2004 by izenbei0>
Review Markings:

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04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: PUBLIC COPORATION LAW AND U.S. INVESTORS
TAGS: EFIN, EINV, KS, US
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006